

Child and Dependent Care and Early Childhood Development Tax Credits

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Introduction

- Iowa Child and Dependent Care (CDC) Tax Credit is 30 to 75 percentage of the federal CDC for those whose net Iowa income is less than \$45,000.
 - Federal Child and Dependent Care Tax Credit is 20 to 35 percent of the eligible child care expenses for qualifying children under age 13 or disabled dependents.
- Iowa Early Childhood Development (ECD) Tax Credit is 25 percent of first \$1,000 of eligible early childhood development expenses per child between ages 3 and 5 from families with net Iowa income less than \$45,000.
- Taxpayers can claim only one of the two Iowa credits in one tax year.

Facts about Child Care in Iowa

➤ Child care is a cost of working

➤ Child care cost in Iowa

- In 2011, average cost of 4-year-old care center in Iowa was \$7,551
- Average college tuition and fees was \$7,562 (Child Care Aware® of America, 2012)

➤ Child care needs in Iowa

- Iowa's percentage of children under age 6 with all parents in labor force ranked 3rd in 2012 (ACS data)

➤ Additional major State benefits for child care:

- Iowa's Child Care Assistance: In fiscal year 2013, 22,851 households received \$100 million, of which the State spent \$61 million (DHS data)
- Dependent Care Flexible Spending Account: Employers can offer employees the ability to set aside pre-tax income to pay for eligible child care expenses

Federal Child and Dependent Tax Credit

- Requires a taxpayer to work or to seek employment
- Applies to qualifying children or disabled dependents
 - Children must be under age 13
- Eligible expenses
 - Eligible expenses must be work-related
 - Limited to \$3,000 for one child/\$6,000 for two or more
- Equals 20 to 35% of eligible expenses
 - Rate falls as income increases
- Nonrefundable

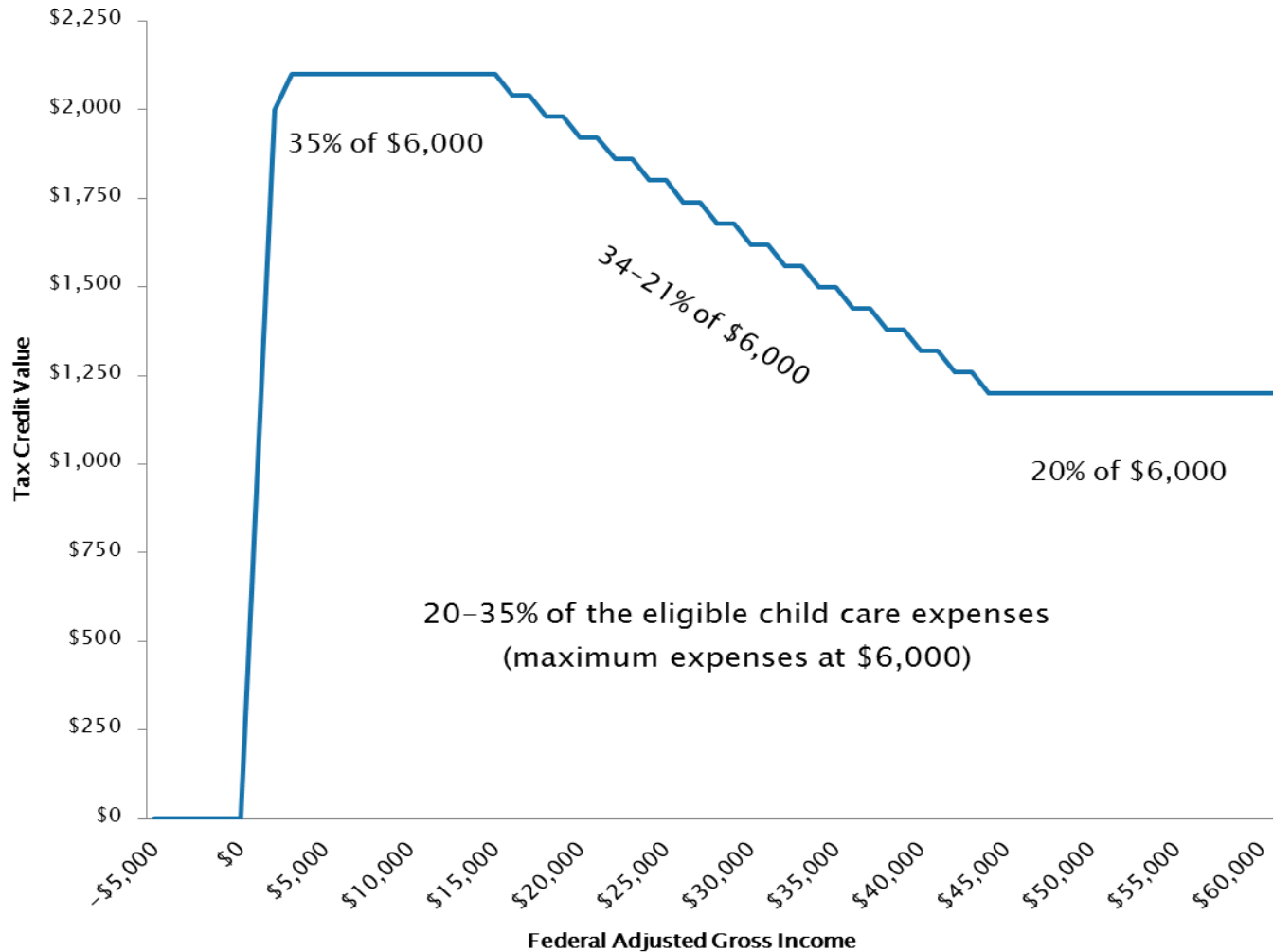
The federal CDC benefits flow mainly to middle and high income families and lower income families only receive negligible benefit from the credit.

Iowa's Child and Dependent Tax Credit

- Similarities to the federal CDC Tax Credit
 - Requires taxpayers to work or seek employment
 - Qualifying children
 - Eligible expenses
 - No indexation for inflation

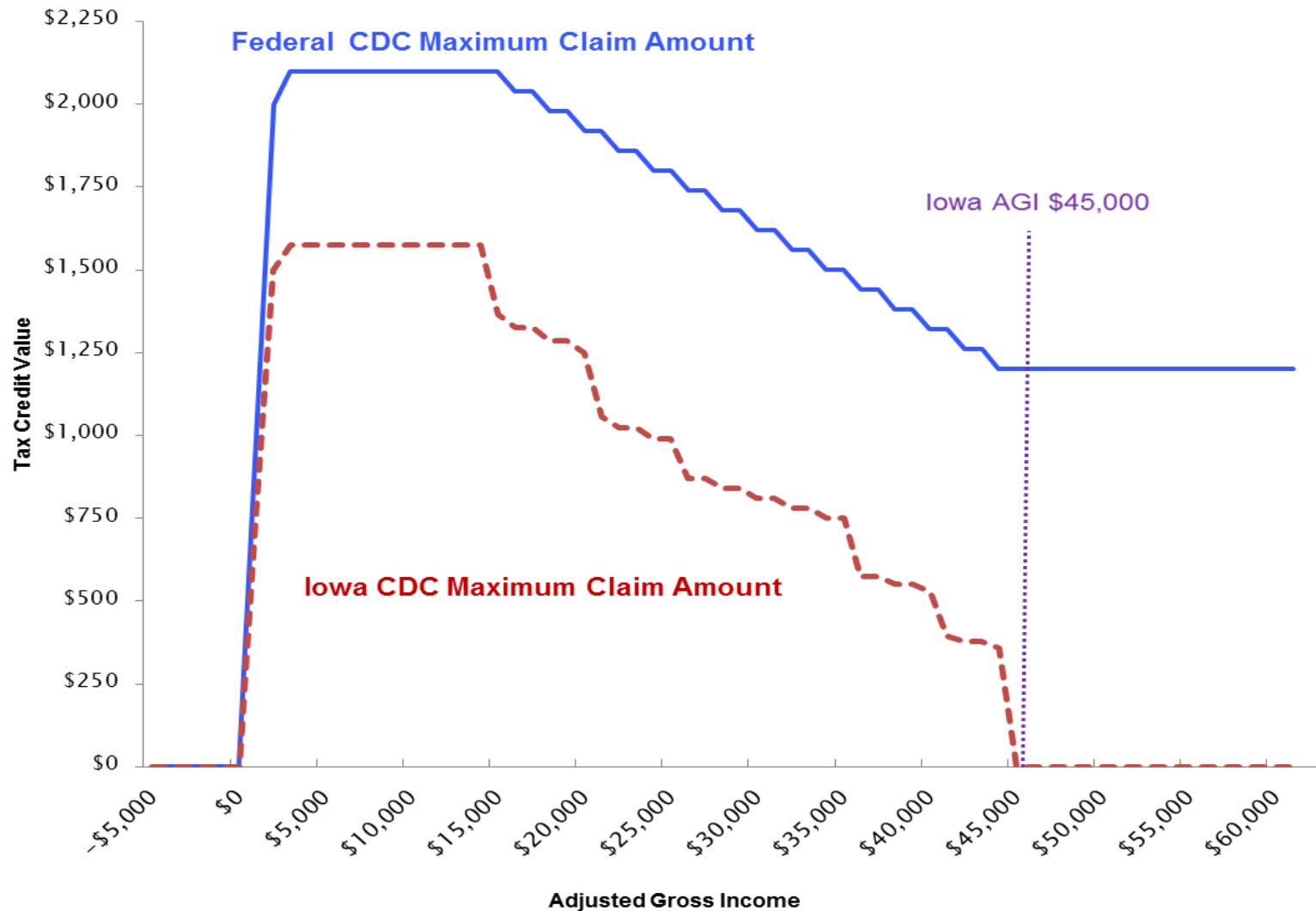
- Differences from the federal CDC Tax Credit
 - 30 to 75% of the federal CDC Tax Credit
 - Only allowable for those with income less than \$45,000
 - Refundable

Federal CDC Maximum Amount by Income Level for a Family With Two Qualifying Children



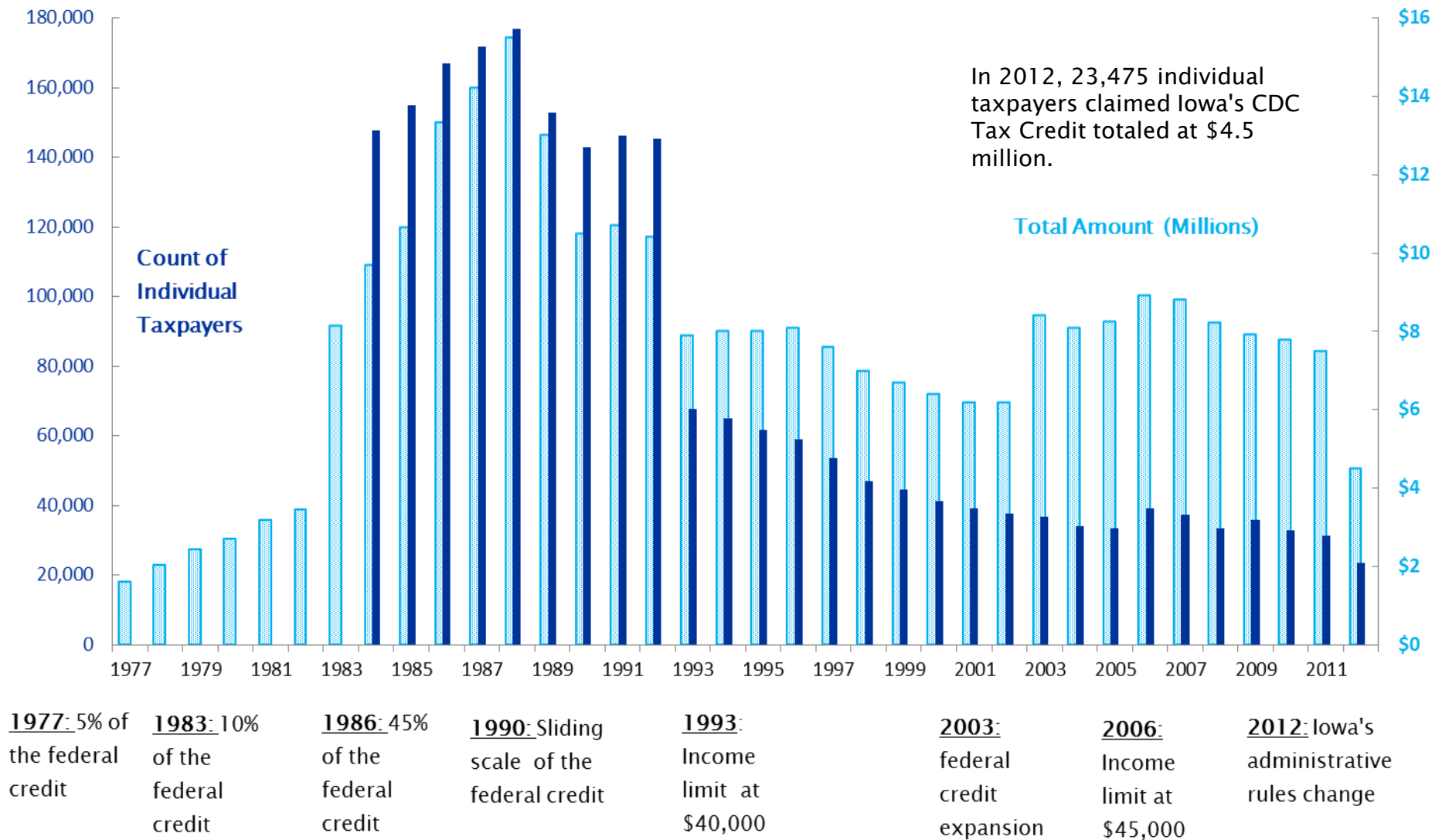
Source: Internal Revenue Service (2013), Publication 503. Child and Dependent Care Expenses.

Federal and Iowa CDC Maximum Amounts For A Family With Two Qualifying Children



Source: IRS Publication 503 and Iowa Code Iowa tax code 42.12C.

Numbers of Claimants and Amount of Iowa's CDC Tax Credit



2012 Iowa CDC Administrative Rules Change

- In response to some taxpayer protests, effective beginning in tax year 2012, the administrative rules were revised to clarify that the allowed federal CDC for the Iowa CDC calculation is the actual received amount of federal CDC.
 - Iowa Administrative Bulletin (Sep 19, 2012): *“42.15(1) The Iowa child and dependent care credit is computed as a percentage of the child and dependent care credit which is **allowed** for federal income tax purposes under Section 21 of the Internal Revenue Code. For taxpayers whose federal child and dependent care credit is limited to their federal tax liability, the Iowa credit shall be computed based on the lesser amount.”*
 - This change is supported by case law that tax credits and exemptions from taxation are to be construed strictly against the taxpayer and liberally in favor of the taxing body.
- As a result, taxpayers with no federal tax liability who cannot receive the nonrefundable federal credit can no longer receive Iowa's credit.

Tax Benefits for Child Care Expenses in Other States

- 27 states including the District of Columbia have one or more tax benefit that offers assistance to working families paying for child and dependent care expenses.
 - 4 states offer deductions for federal CDC expenses
 - 22 states offer one or more tax credit
 - 1 state has both a credit and a deduction

How Are State CDC Tax Credits Related to the Federal Tax Credit?

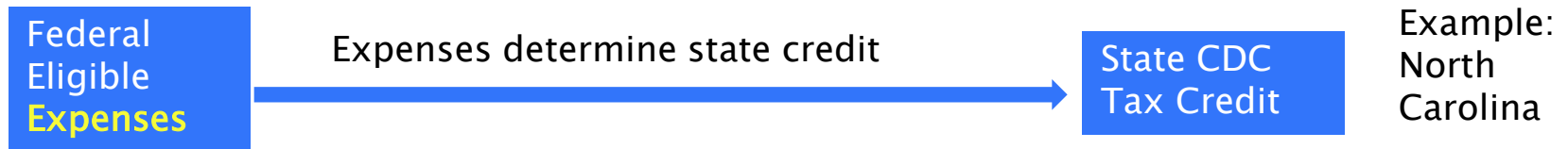
- 3 states offer tax credits not linked to the federal CDC

State credit is unrelated to federal credit

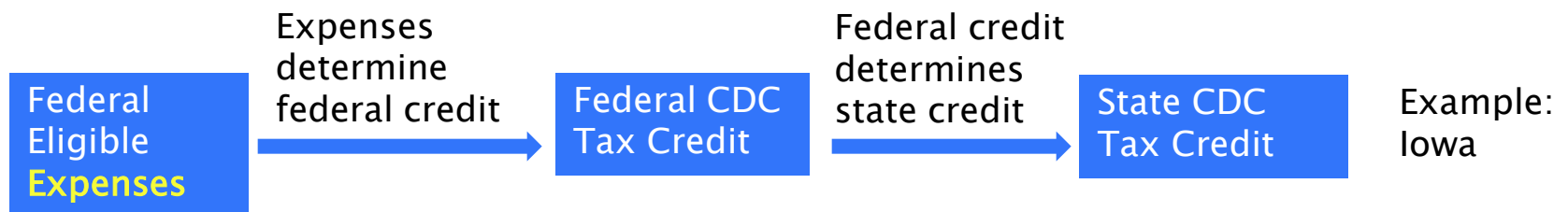
State CDC
Tax Credit

Example:
Hawaii

- 4 states offer tax credits tied to the federal CDC expenses



- 17 states offer tax credits based on a percentage of the federal CDC



Details About Tax Benefits for Child Care Expenses in Other States

- The ranges of top credit percentages among these states are:
 - Below 25% 5 states
 - Between 25%–50% 3 states including the District of Columbia
 - Between 50%–100% 7 states (including Iowa and Minnesota)
 - Above 100% 4 states (including Nebraska)
- 11 states have income limits on their CDC
 - Limits range between \$30,000 and \$100,000
- 13 states have refundable CDC

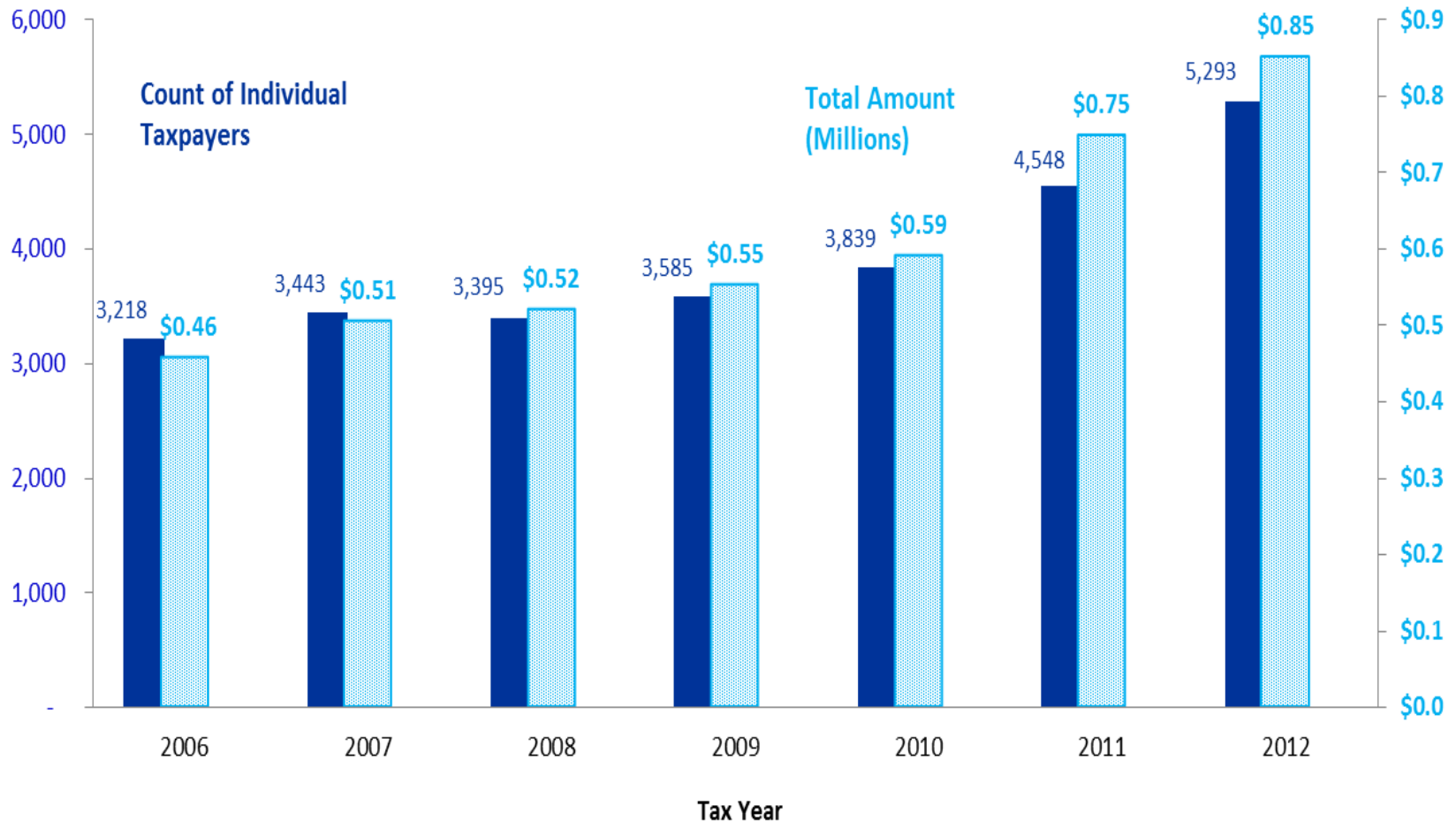
Iowa Early Childhood Development Tax Credit

Compared with Iowa's CDC

	<u>Iowa Child and Dependent Care Tax Credit</u>	<u>Iowa Early Childhood Development Tax Credit</u>
Year enacted	1977	2006
Based on a federal tax credit	Yes	No
Requirement for work	Yes	No
Qualifying children age	Aged under 13	Aged Between 3 and 5
Eligible expenses	Child care expenses	Early childhood development expenses
Maximum expenses amount	\$3,000 per child/\$6,000 two or more	\$1,000 each child
Maximum credit amount	\$788 per child/\$1,575 two or more	\$250 each child
Income limit	\$4,5000; no indexation	\$4,5000; no indexation
Refundability	Refundable	Refundable

Source: Iowa Code Section 422.12C.

Number of Claimants and Amount of ECD Tax Credit



Source: Iowa Individual income tax returns data, tax years 2006–2012.

Similar Tax Relief for Early Childhood Development Expenses in Iowa and Other States

- No other states identified with tax credits for early childhood development expenses
- Many states offer free preschool programs to help with preschool expenses
 - 41 states including the District of Columbia had some form of state-funded free preschool programs in tax year 2011
 - Iowa's State spending per child enrolled in pre-kindergarten/preschool was \$3,423 in tax year 2011
 - Iowa's total State spending on pre-kindergarten/preschool was \$79 million in 2011 (Barnett et. al.,2012)
 - State spending includes the Statewide Voluntary Preschool Program for Four-Year-Old Children
 - 21,402 children were enrolled in 2012 with State spending of \$60 million in 2012 (SWVPP Fact Sheet, 2013)

Income Distribution of Beneficiaries of Iowa's Child and Dependent Care Tax Credit

Iowa Adjusted Gross Income	Number of Households	Distribution of Households	Total Claims	Distribution of Claims	Average Claim
\$0 or less	134	0.5%	\$64,846	0.9%	\$484
\$1-\$4,999	506	1.9%	\$160,956	2.1%	\$318
\$5,000-\$9,999	1,414	5.3%	\$491,890	6.6%	\$348
\$10,000-\$14,999	2,297	8.6%	\$766,430	10.2%	\$334
\$15,000-\$19,999	3,466	13.0%	\$1,236,492	16.5%	\$357
\$20,000-\$24,999	4,139	15.5%	\$1,304,032	17.4%	\$315
\$25,000-\$29,999	4,049	15.2%	\$1,192,701	15.9%	\$295
\$30,000-\$34,999	3,832	14.3%	\$1,106,822	14.8%	\$289
\$35,000-\$39,999	3,500	13.1%	\$709,306	9.5%	\$203
\$40,000-\$44,999	3,374	12.6%	\$458,678	6.1%	\$136
Total	26,711	100.0%	\$7,492,153	100.0%	\$280

Source: Iowa individual income tax returns data, tax year 2011.

Iowa's CDC claimants are concentrated in the income levels between \$10,000 and \$44,999.

Characteristics of Child and Dependent Care Tax Credit Claimants

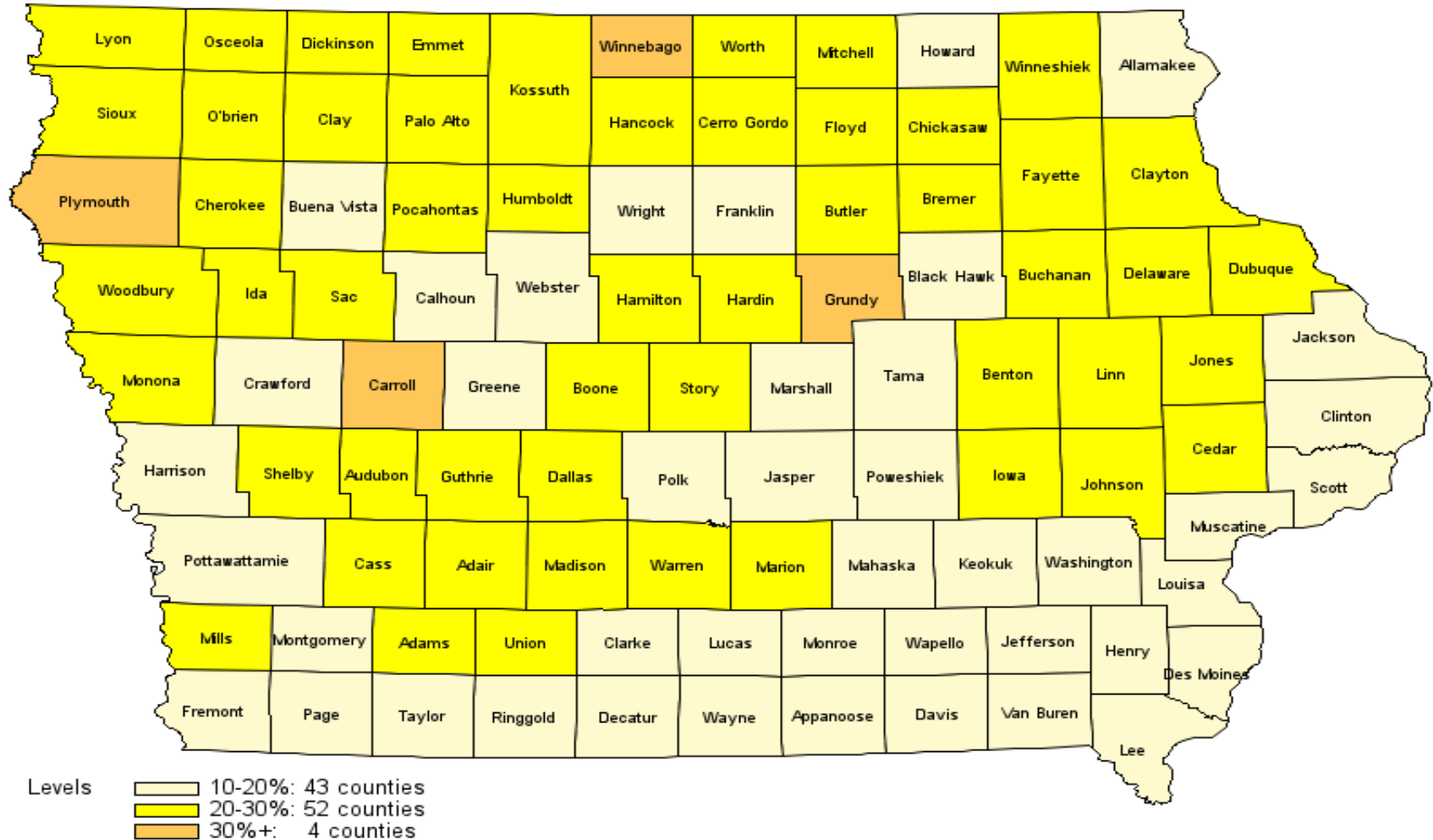
Tax year 2011	Distribution of Count	Distribution of Amount
Nonmarried	75.5%	81.7%
Married	24.5%	18.3%
By Number of Dependents Aged Under 13*		
1	54.5%	51.8%
2	25.9%	30.1%
3	6.9%	7.1%
4 or over	1.1%	1.1%
By Age of Oldest Children Aged Under 13*		
0 to 3	20.1%	20.4%
3 to 5	26.1%	29.5%
5 to 12	42.2%	40.1%
By Age of Primary Taxpayer		
20 or Under	2.0%	1.7%
21 to 25	18.1%	19.5%
26 to 30	29.6%	31.3%
31 to 35	23.8%	23.5%
36 to 40	13.9%	13.2%
41 to 45	7.4%	6.6%
Over 45	5.2%	4.2%
Resident	95.3%	96.8%
Nonresident	4.7%	3.2%

Source: Iowa Individual Income returns Data.

* Totals of percentages are less than 100% due to missing data on dependents' ages or zero children under age 13.

Distribution of Iowa's CDC Take-Up Rate By County

Tax Year 2011



Take-up rate is the number of households claiming the Iowa's CDC divided by the number of households filing taxes identified with children under age 13 and income less than \$45,000.

How Many Consecutive Years Do Taxpayers Claim the Child and Dependent Care Tax Credit?

Spell Length Distribution of Iowa's CDC

Tax Years 1996–2012

Spell Length	Distribution of Spell Length
1 Year	45.6%
2 Years	24.7%
3 Years	12.2%
4 Years	6.7%
5 Years	4.0%
6 Years	2.4%
7 Years	1.6%
8 Years	1.0%
9 Years	0.6%
10 Years or Over	1.0%
Total Number of Spells	87,551
Average Length	2.3 years
Share with Multiple Spells	45.5%

Source: Iowa individual income tax returns data.

- The length of a spell equals the number of consecutive years when a taxpayer claims a tax credit.
- The average spell lasts 2 years only, which is shorter compared with other tax credits spells.
- Why do taxpayers not continue claiming the credit as their child(ren) grow to age 12?

Why Do Taxpayers Stop Claiming the Child and Dependent Care Tax Credit?

- Taxpayers who claimed CDC in 2009 but did not claim in 2010:

Factors	Sharing experiencing Exclusive of Other Factors Noted Above
low income rises above \$45,000	29.8%
No longer have children under age 13	7.5%
New Marriage	1.7%
Move out of Urban Counties	1.1%
Total Above	40.1%
Other	59.9%

Source: Iowa individual income tax returns data, tax years 2009–2010.

How Well Does the Credit Help Parents Offset Child Care Costs When They Work or Look for Work?

For households with income between \$20,000-\$24,999 :

(1)	Average Amount of Iowa's CDC Per Household Claimed	\$204
(2)	Average Amount of federal CDC Per Household Claimed	\$550
(3) =(1)+(2)	Average Amount Per Household Claimed(federal, Iowa)	<hr/> \$754
(4)	Average Cost of 4-Year-Old Child Care Per Child	\$7,551
(5) =(3)/(4)	Share of Child Care Cost Covered by CDC	10.0%

- Only a small portion of child care expenses can be covered by the federal and Iowa CDC tax credits
- Consider how changes in the credit could result in higher coverage

Possible Changes to Iowa's Child and Dependent Care Tax Credit

Possible Changes	Estimated Fiscal Impacts for Tax Year 2013 (in Millions)	Average Credit Amount per Household Under Change if Income Between \$20,000 and \$24,999	Share of Child Care Cost Covered by Credits Under Change
A. Modify Iowa Code to allow Iowa CDC claims regardless of federal tax liability	-\$2.8	\$289	11.1%
B. Index income limit and brackets using 1993 as base year	-\$3.2	\$249	10.6%
C. Raise Iowa CDC percentage of federal credit by 25 percentage points (for example, percentage raised from 55% to 80% for income between \$20,000 and \$24,999)	-\$1.8	\$300	11.3%
D. Raise Iowa credit to 100% federal CDC, keeping \$45,000 income limit	-\$4.0	\$385	12.4%

Source: Iowa individual income tax micro model from fiscal year 2013 is used for the estimations.

Estimates subject to change for fiscal year 2014 legislation session.

The estimated average Iowa credit amount per household for those with income between \$20,000-\$24,999 is \$204 in 2013.

Questions?